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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1967

No. 614

R. A. HOLMAN & CO., INC., *Petitioner,*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent.*

R. A. HOLMAN & CO., INC., AND RICHARD A. HOLMAN, *Petitioners,*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent.*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioners pray that a Writ of Certiorari issue to review the judgments of the United States Court of Appeals for the Second Circuit entered September 21, 1966, petition for rehearing granted, opinion amended, and judgments reaffirmed on May 15, 1967.

## OPINIONS BELOW

On September 21, 1966, the Court of Appeals affirmed an order of the Securities and Exchange Commission revoking the registration of petitioner R. A. Holman & Co. as a broker and dealer, expelling it from membership in the National Association of Securities Dealers, Inc., and making permanent an earlier SEC order temporarily suspending the exemption from registration requirements of an offering of securities. The opinion in this case is printed in Appendix A at pp. 1a-16a, *infra,* and is reported at 366 F.2d 446 (1966).

Petitioner's petition for rehearing was granted and on May 15, 1967, the Court handed down another opinion, amending its former opinion, but re-affirming its earlier judgment. This opinion is printed in Appendix B at pp. 17a-23a, *infra,* and is reported at 377 F.2d 665 (1967).

Also on September 21, 1966, the Court of Appeals affirmed an order of the District Court for the Southern District of New York, permanently enjoining petitioners R. A. Holman & Co. and Richard A. Holman, at the suit of the SEC, from specified violations of Section 17(a) of the Securities Act of 1933 and Section 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 77q(a), 78o(c)(1). The opinion in this case is printed in Appendix C at pp. 24a-27a, *infra,* and is reported at 366 F.2d 456 (1966).

The Court denied rehearing in this case on May 15, 1967. Its denial is reported at 377 F.2d 665 (1967).

## JURISDICTION

The United States Court of Appeals for the Second Circuit had jurisdiction under Section 9 of the Securities Act of 1933, 15 U.S.C. § 77i, Section 25 of the

Securities Exchange Act of 1934, 15 U.S.C. § 78y, and 28 U.S.C. § 1291. The judgments were entered on September 21, 1966, and were re-affirmed on the disposition of the petition for rehearing on May 15, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1). The time for filing a Petition for Certiorari was extended by this Court to September 13, 1967.

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The constitutional provision involved is the Due Process Clause of the Fifth Amendment to the Constitution of the United States.

The statutory provisions involved are: Sections 5(c), 7(a), and 11 of the Administrative Procedure Act, 5 U.S.C. §§ 1004(c), 1006(a), 1010; Sections 3(b), 8(b), 8(d), and 17(a) of the Securities Act of 1933, as amended, 15 U.S.C. §§ 77c(b), 77h(b), 77h(d), and 77q(a); and Sections 15(b) and 15(c)(1) of the Securities Exchange Act of 1934, as amended, 15 U.S.C. §§ 8o(b), 78o(c)(1). They are printed in Appendix D, p. 28a, *infra.*

## QUESTIONS PRESENTED

1. Do constitutional standards of due process and the Administrative Procedure Act permit a prosecutory proceeding in an administrative agency, which can result in the destruction of a valuable going business, to be conducted by a Hearing Examiner who is appointed by the agency and whose status as Hearing Examiner is terminable at the will of the appointing agency?

2. Do constitutional standards of due process and the Administrative Procedure Act permit a member of an administrative agency to participate in an adjudicative proceeding when he has previously been a member of the agency's staff with responsibility for the investigation from which the charges in the proceeding arose?

3. When a *prima facie* showing of the disqualification of an agency member is made, may that member refuse to disclose facts relevant to the issue of his disqualification which are peculiarly and exclusively within his own knowledge?

4. May predictions of future increase in a stock price be held to be *per se* fraudulent in injunctive proceedings initiated by the SEC in the District Courts, when the same predictions could not be held fraudulent in an administrative proceeding before the SEC in the absence of a showing that the predictions were without reasonable basis in the light of such factors as the sales and earnings of the company and the market history of its shares?

## STATEMENT OF THE CASE

### A. Introduction

This case, as the SEC itself has stated:

> "raises a question of first impression, having government-wide implications affecting the validity of all proceedings presided over by retired Hearing Examiners who have been reemployed."

It involves the administrative expulsion of a company from the securities business in a proceeding con-

ducted by a Hearing Examiner who was totally dependent for his continued tenure and compensation on the will of the agency which appointed him.

This case also raises the issues whether an administrative official may exercise investigative, prosecutive, and then adjudicative responsibilities in the same proceeding and whether a litigant may be blocked from obtaining the facts relevant to the disqualification of that official to sit in judgment in the case.

### B. The Parties and Proceedings Below

Petitioner R. A. Holman & Co. was registered with the SEC in 1958 as a broker-dealer under Section 15(b) of the Securities Exchange Act of 1934. Petitioner Richard A. Holman, an attorney, is its president and sole stockholder.

R. A. Holman & Co. specialized in underwriting the securities of small companies unable to command the services of the major Wall Street investment firms. The major part of its business involved the underwriting of securities issues filed pursuant to Section 3(b) of the Securities Act of 1933 and Regulation A of the SEC governing offerings of $300,000 or less.

Both cases involved in the present petition—an administrative proceeding by the SEC against R. A. Holman & Co.[1] and a suit for injunction by the SEC against R. A. Holman & Co., Richard A. Holman, and others in the District Court for the Southern District

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[1] Docket No. 30276 in the Court below. Record citations relating to this case are to the printed Appendix for Petitioner in the Court below, cited as (Pet. App. ), and to the transcript of proceedings, cited as (R. ).

of New York[2]—arose out of an underwriting by R. A. Holman & Co. of securities of Pearson Corporation, a small Rhode Island boat company manufacturing pleasure craft.

This company was financed by R. A. Holman & Co. in a Regulation A offering in 1959 after other brokers had refused to underwrite it. (Pet. App. 228a-229a, 249a). The underwriting was a success, the price of Pearson stock rose, and Pearson's sales and earnings greatly increased. As the Court below acknowledged, this company "was not, in contrast to the companies involved in many securities fraud cases, a 'fly-by-night' company" but "produced and still produces an outstanding line of fiber-glass boats." (Appendix B, *infra,* p. 17a; 366 F.2d at 457).

**1. The Administrative Proceeding**

In 1960 the Pearson management decided to raise additional capital to finance further expansion. On March 30, 1960, Pearson filed a full registration (Form S-1) with the SEC in Washington covering the proposed offer. R. A. Holman & Co. was again the underwriter.

At that time, and until July 15, 1960, Byron D. Woodside was Director of the Division of Corporate Finance of the SEC. The major responsibility of this Division is to process registration statements filed by prospective offerors of securities. As the SEC conceded, Woodside had, during the period of his directorship, "ultimate responsibility" to the SEC for the

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[2] Docket No. 30039 in the Court below. Record citations relating to this case are to the printed Appendix for Appellants in the Court below, cited as (Apps. App. ).

work of the Division. On July 15, 1960, Woodside was appointed a Commissioner of the SEC.

During the period of his directorship—and for two months thereafter—the Pearson registration remained pending in the SEC. The SEC did not even send Pearson a letter of comment, the first step in processing a registration statement, although the SEC acknowledges that time is of the essence in a securities issue.[3]

Finally, on September 16, 1960, the SEC issued an *ex parte* order suspending the original Pearson Regulation A offering which had been completed in 1959. (Pet. App. 33a-35a). Woodside was one of the three Commissioners voting to issue this order, although R. A. Holman & Co. was not informed of the fact until over a year and a half later, despite repeated efforts to obtain this information. (Pet. App. 62a-63a, 64a-66a, 105a).

On September 26, 1960, the SEC issued another order for public proceedings to determine whether to revoke R. A. Holman & Co.'s broker-dealer registration and to suspend or expel it from membership in the National Association of Security Dealers, Inc. The order alleged improper practices in the 1959 underwriting of Pearson stock. (Pet. App. 36a-43a).

The SEC thereafter consolidated the suspension proceeding against the Pearson offering and revocation proceeding against R. A. Holman & Co. and designated William W. Swift as Hearing Officer in the consolidated proceeding. (Pet. App. 46a-48a).[4]

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[3] 26 SEC Ann. Rep. 30 (1960).

[4] The proceeding was also expanded to include charges against R. A. Holman & Co. relating to an unsuccessful offering in another company in 1958 and against a former Holman salesman. (Pet. App. 49a-61a).

Hearings commenced December 16, 1960, and the SEC staff presented its case until March 6, 1962. R. A. Holman & Co. then commenced the defense.

During the course of that defense, counsel for R. A. Holman & Co. learned for the first time that Hearing Examiner Swift had passed the mandatory retirement age for Examiners and was serving under temporary appointment at the will of the SEC. R. A. Holman & Co. thereupon moved on May 15, 1962, to disqualify the Hearing Examiner on the ground that he lacked the independence of tenure and compensation required by law for Hearing Examiners. It also moved to strike the record thus far made. (Pet. App. 83a-92a).

The following facts about the Hearing Examiner's appointment then emerged:

(a) On October 31, 1957, Mr. Swift had been mandatorily retired as a Hearing Examiner; at that time he had been receiving a salary of $11,395 per year.

(b) The next day he was given a temporary one-year appointment by the SEC as a Hearing Examiner. His temporary appointment stated:

> "As provided by the provisions of Section 13(a) of the Civil Service Retirement Act, you may be separated at the will of the appointing officer."

(c) Each year thereafter Mr. Swift received another temporary one-year appointment as Hearing Examiner from the SEC. He also received salary increases, bringing his salary to $14,055 by 1960. Under each appointment he was subject to separation at the will of the SEC.

(d) If it had not been for these successive reappointments, he would have received merely his annual

retirement pay of about $4,700. This would also be his rate of compensation if he were "separated at the will" of the SEC. (Pet. App. 271a-284a).

On May 28, 1962, the SEC resolved this issue—which it acknowledged to be of first impression and great importance (Pet. App. 95a)—by denying the motion on the merits and also on the ground that it was not timely made. A notation at the end of the order of denial disclosed that Commissioner Woodside had participated in the decision. This was the first time that Woodside's participation in this proceeding had been publicly disclosed, although, as subsequently emerged, he had been participating throughout. (Pet. App. 93a-105a).

On May 11, 1962, the Court of Appeals for the District of Columbia Circuit had decided the case of *Amos Treat & Co.* v. *SEC,* 306 F.2d 260 (1962). The Court there invalidated action taken by the SEC with the participation of a Commissioner who had served with the divisional staff unit which investigated the case and was prosecuting the complaint.

Immediately on learning of Woodside's participation through the notation at the end of the SEC's Opinion of May 28, 1962, R. A. Holman & Co., in accordance with the *Treat* decision, sought to have the SEC discontinue the proceeding. In the alternative, it asked that the SEC hold a full evidentiary hearing to determine whether Woodside should be disqualified because of his prior staff service at the time the Pearson registration statement was pending. When the SEC failed to grant relief, R. A. Holman & Co. filed a complaint for an injunction in the District Court for the District of Columbia to restrain further proceedings

by the SEC on two grounds: (a) Commissioner Woodside's participation was unlawful; and (b) Hearing Examiner Swift was disqualified by reason of his lack of independence from the SEC.

On July 6, 1962, the District Court granted an injunction against further administrative proceedings on the basis of Woodside's participation.

While this injunction was on appeal by the SEC and while the SEC was restrained from acting in the administrative proceeding, the Commission continued its pursuit of Petitioners by filing a suit on March 15, 1963, in the District Court for the Southern District of New York against the company, Richard A. Holman, and three Holman salesmen. This action charged them with violations of the securities laws in connection with the offer and sale of Pearson common stock during the preceding six months. (Apps App. 2a-8a).

The Court of Appeals for the District of Columbia Circuit on June 13, 1963, reversed the grant of the injunction against the administrative proceeding solely on the ground that R. A. Holman & Co. had not exhausted its administrative remedies. *SEC* v. *R. A. Holman & Co.*, 323 F.2d 284 (1963), *cert. denied*, 375 U.S. 943. The Court emphasized that Holman should make its record on the unlawful participation of Commissioner Woodside before the SEC and the Court would then carefully review the SEC's determination of the matter. The Court stated:

> "We are satisfied that such claims as the appellee has here presented should be adduced in the first instance at the administrative level and any challenge to the resolution of these issues is subject to judicial review when the administrative record reaches us in due course . . . [A]t that

> stage we will scrutinize the issue of disqualification with great care." 323 F.2d at 287.

The Court also indicated the leeway to be accorded R. A. Holman & Co. in establishing its claims:

> "The party asserting disqualification must make his record in the administrative hearing. While the scope and nature of that inquiry has never been fully delineated it must be sufficient to allow the challenging party to introduce whatever relevant evidence he possesses bearing on disqualification since he, of course, has the burden of proof." (*Ibid.*)

In accordance with the mandate of the Court of Appeals, R. A. Holman & Co. then sought subpoenas from the Hearing Examiner, directed to Woodside and various staff employees of the SEC who had knowledge of Woodside's relationship to the Pearson investigation while he was Director of the Division of Corporate Finance. Hearing Examiner Swift denied the subpoenas on the ground that they were "a fishing expedition" and that R. A. Holman & Co. had not offered "substantial evidence to support its charge of disqualification against Commissioner Woodside." (R. 8219).

The Commission affirmed the denial of these subpoenas. *Commissioner Woodside himself participated in this decision.* (Pet. App. 120a-124a).

At the conclusion of the administrative hearings, Hearing Examiner Swift handed down a recommended decision adopting almost verbatim the proposed findings and conclusions of the SEC staff. When the case reached the Commission, Woodside announced that although he did not regard himself as disqualified, he had decided not to participate further in the

SEC's consideration of the matter because of the charge of disqualification against him.[5] Up to that point, he had participated in an undetermined number of rulings by the SEC on issues arising during the course of the proceedings.[6]

The SEC thereafter published its findings, opinion, and order that R. A. Holman & Co. had violated the securities laws, that its broker-dealer registration should be revoked, and that it should be expelled from the NASD. (Pet. App. 3a-32a).

R. A. Holman & Co. appealed from that order of the SEC to the Second Circuit.[7] The Second Circuit upheld the sufficiency of the evidence on which the SEC had based its order and rejected the contentions that the proceeding before the SEC violated the Administrative Procedure Act and denied due process of law. With respect to these contentions, the Court held that:

(a) "[W]e do not think the record before us establishes that Commissioner Woodside was disqualified within the meaning of the *Treat* case." P. 10a, *infra;* 366 F.2d at 524. The basis for this holding was that "the record here does not show that Woodside was 'engaged in the performance of investigative or prosecuting functions' in any proceedings related to the

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[5] He also stated that by withdrawing, he wished "to avoid providing a possible further occasion for delay." (R. 16242-4).

[6] The SEC did not, except in rare instances such as its opinion on the Hearing Examiner, note the names of the Commissioners who participated in rulings announced by it.

[7] The appeal could only be taken to the Second Circuit, rather than to the District of Columbia Circuit, because the SEC injunction action against petitioners was in the Second Circuit and it was desired to obtain joint argument of the two cases.

present case, so as to be barred by Section 5(c) of the Administrative Procedure Act from participation in adjudicatory proceedings against the petitioner." P. 11a, *infra;* 366 F.2d at 453.

(b) R. A. Holman & Co. was not unduly restricted in its inquiry into Woodside's disqualification by SEC denial of subpoenas for Woodside and the staff members. The Court ruled that the nature of Woodside's participation in the events leading up to the filing of charges against R. A. Holman & Co. had been adequately disclosed by statements in the SEC's answer and the affidavit of a staff member in the injunction suit against the SEC proceeding by R. A. Holman & Co. in the District Court for the District of Columbia.

No affidavit or statement of Woodside himself was before the Court below. The statements referred to were statements by others denying that Woodside had participated in any informal investigation of Holman's activities in connection with the Pearson registration statement, claiming that Woodside had not acquired "substantial knowledge" of the facts in issue, and asserting that the investigation had been under the supervision of Assistant Director of Corporate Finance Eisenhart. Eisenhart in an affidavit merely denied that he "discussed" the Pearson registration statement with Woodside until after Woodside left the Division and became a Commissioner.

The Court said:

> "In light of these statements, petitioner, who had the burden or proof on the disqualification issue . . . was obliged either to offer

evidence contradicting the sworn statements of the Commission, or to point out the inadequacy and inconsistency, if any, in the sworn statements, before he was entitled to subpoena the Commission members and staff."

(c) The challenge to the qualifications of Hearing Examiner Swift was not timely and it was therefore unnecessary to consider the merits of the disqualification motion against him. In this connection, the Court rejected the sworn statement of R. A. Holman & Co.'s counsel—never challenged or denied by the SEC—that he was unaware until April, 1962, that Swift was over the mandatory retirement age of 70 and was serving at the will of the SEC. (Pet. App. 84a-92a).

In its complaint in the injunction action in the District Court for the District of Columbia, plaintiff alleged:

"The information as to Mr. Swift's birthday came to plaintiff's and its counsel's attention for the first time on April 25, 1962.

* * *

"Prior to April 25, 1962 plaintiff had no knowledge of the facts that disqualify Mr. Swift as Hearing Examiner."

As to both these allegations, the SEC in its answer neither admitted nor denied them, which constituted an admission of their truth under Rule 8(d) of the Federal Rules of Civil Procedure.

The Court below nevertheless said:

"The hearing examiner's age must have been obvious at the beginning of the hearings in De-

> cember 1960, at which time Swift was over 73. The failure to challenge Swift's qualifications on the ground of his temporary reappointment over the retirement age at some early stage of the proceedings precludes the raising of a similar objection at this point." P. 14a, *infra*, 366 F.2d at 454.

Subsequently, in its opinion on the grant of rehearing in this case, the Court below acknowledged several factual errors and omissions in its original opinion. It made still another correction in response to a letter from the SEC. But it refused to disturb its affirmance of the judgment.

**2. The Court Proceeding**

The complaint in the SEC's injunction action in the Southern District of New York charged the company, Richard A. Holman, and three Holman salesmen with violations of Section 17(a) of the Securities Act of 1933 and Section 15(c)(1) of the Securities Act of 1934. It alleged that the defendants embarked on a selling campaign in Pearson stock in the fall of 1962, during which they had made statements as to the future market price of Pearson stock and had omitted to state facts which would show the lack of any reasonable basis for these predictions. The suit sought an injunction against future violations in the offering and sale of Pearson stock and any other security. (Apps. App. 2a-8a).

The SEC's allegations were vigorously contested by petitioners. Judge Bonsal denied the SEC's request for a preliminary injunction. (Apps. App. 1a).

The case then came on for trial before Judge Wham, a retired district judge of the Northern District of

Illinois, sitting by designation. The SEC introduced evidence that a salesman had offered investors Pearson stock at $4½ a share and had stated that Pearson stock would probably rise to about $10 in the next several months. Petitioners introduced evidence that there was a reasonable basis in fact for such predictions:

(a) Pearson had just reported the highest sales and earnings in its history in its report for the first six months of 1962; the president of Pearson publicly stated as his opinion that sales and earnings for the rest of 1962 would also be at a record level and that sales and earnings would be even higher in 1963;

(b) the market history of the stock showed that it had risen at the start of previous annual New York Boat Shows, and the 1963 Boat Show was approaching at the time the predictions were allegedly made;

(c) in 1960 the stock had risen from $4¼ to $13¾ in a matter of two months, an increase of 200%, and had traded for long periods at over $10 a share;

(d) Pearson had been merged with Grumman Boats, Inc., a subsidiary of Grumman Aircraft, in December, 1960, which resulted in Grumman Aircraft owning over 61% of Pearson's common stock. Grumman executives went on the Pearson Board of Directors. Grumman had helped Pearson obtain needed financing. In March, 1963, Pearson was merged with Grumman Allied, a newly created Grumman subsidiary. The SEC suit against Petitioners was commenced on

the eve of this merger, despite the fact that Pearson was about to disappear from the corporate scene.

(e) The Grumman Aircraft Engineering Corporation was showing continuing interest in Pearson and giving it financial support. The Grumman affiliation gave Pearson additional managerial and financial strength.

At the conclusion of the trial, Judge Wham adopted verbatim the SEC's proposed findings of fact and conclusions of law. The Court granted a final injunction exactly as proposed by the SEC. Judge Wham merely accepted the proposed findings and order presented him by the SEC without so much as a comma change. (Apps App. 404a-422a). This is the practice criticized by this Court in *United States* v. *El Paso Natural Gas Co.*, 376 U.S. 651, 656-657 (1964).

With respect to the predictions of increases in the price of Pearson stock, the Court found that "[t]here was no basis in fact for any of these predictions." (Apps. App. 408a). It concludes that:

> "It is well settled that predictions by securities salesmen of market price increases in the stock being sold, whether such predictions be couched in the form of a mere opinion or otherwise, are, when made recklessly or without reasonable basis in fact, violative of the anti-fraud provisions of the federal securities laws." (Apps. App. 414a).

At no point in its findings or conclusions did the District Court make any analysis of Pearson's financial condition to determine whether there was a reasonable basis in fact for the predictions. At no point did it analyze the evidence adduced by petitioners

which showed that there was a reasonable basis in fact for the predictions.

On appeal to the Second Circuit, the Court affirmed the judgment below. The Court conceded at the outset that:

> "we are not convinced that all of the statements and omissions described by the trial court were materially misleading under the circumstances in which they were made (or not made)." P. 19a, *infra;* 366 F.2d at 457.

With respect to the matter of the price predictions, however, the Court held:

> "the specific price predictions were themselves violative of the antifraud provisions of the federal securities laws, since no adequate basis existed for representations so optimistic." P. 22a, *infra;* 366 F.2d at 458.

Like the District Court, the Court of Appeals failed to indicate any evidence in the record showing that no adequate basis existed for such predictions. Its opinion, like the findings and conclusions of the District Court, is entirely silent on any facts or circumstances which indicate that these predictions were without reasonable basis at the time they were made.

## REASONS FOR GRANTING THE WRIT

This Petition presents important issues concerning the proper exercise by administrative agencies of their quasi-judicial powers. It raises the question whether administrative agencies are free from fundamental principles of fair adjudication which have always governed our courts—that adjudicative officials

should not be dependent on the authority appointing them for their continued tenure and compensation and that investigative, prosecutorial, and adjudicative functions should not be intermingled in the same individual. This Court should resolve these questions because of the public interest in assuring that administrative agencies which have the power of economic life and death over individuals carry out their adjudicative functions in accordance with high procedural standards.

This Petition also presents an important question of statutory interpretation of the securities laws: whether a federal District Court, enforcing the anti-fraud provisions of these laws, is free, at the SEC's behest, to impose a *per se* rule of violation on predictions as to future stock prices, although the SEC, enforcing the same provisions in an administrative proceeding, is required to demonstrate the facts or circumstances which deprive such predictions of any reasonable basis in fact. This is a question of great moment to the securities industry, which requires reasonable legal certainty in such matters in order to carry out its function of distributing securities.

**I. The Administrative Proceeding Is Invalidated Because Hearing Examiner Swift Served at the Will of the SEC, in Violation of the Administrative Procedure Act and Principles of Due Process of Law.**

This contention, as the SEC itself concedes:

> "raises a question of first impression, having government-wide implications affecting the validity of all proceedings presided over by retired Hearing Examiners who have been re-employed." (Pet. App. 95a).

Section 11 of the Administrative Procedure Act provides in unmistakable terms that:

> "Examiners shall be removable by the agency in which they are employed only for good cause established and determined by the Civil Service Commission . . . after opportunity for hearing and upon the record thereof."

The statute also provides that:

> "Examiners shall receive compensation prescribed by the [Civil Service] Commission independently of agency recommendations . . . ."

The purpose of this section is beyond doubt or dispute. The authoritative legislative history of the APA states:

> "Section 11 recognizes that agencies have a proper part to play in the selection of examiners in order to secure personnel of the requisite qualifications. However, once selected, *under this bill the examiners are made independent in tenure and compensation* by utilizing and strengthening the existing machinery of the Civil Service Commission.
>
> "Accordingly, Section 11 requires agencies to appoint the necessary examiners under the civil service and other laws not inconsistent with the bill. But *they are removable only for good cause determined by the Civil Service Commission after a hearing, upon the record thereof, and subject to judicial review. Moreover, their compensation is to be prescribed and adjusted only by the Civil Service Commission acting upon its independent judgment.*" Administrative Procedure Act, Legislative History, Senate Document No. 248, 79th Cong., 2d Sess. (1946), p. 371 (Emphasis supplied).

It is clear that Hearing Examiner Swift lacked the independence from the SEC required by the APA.

None of the facts as to this point is in dispute. As a retired Hearing Examiner, he was serving under a temporary year-to-year appointment, terminable at the will of the appointing agency, the SEC. Each time he was reappointed he was specifically informed that he could be "separated at the will of the appointing officer." He was subject to dismissal by the SEC without the good cause, hearing, and judicial review explicitly provided for in the APA. His annual reappointment was completely within the discretion of the SEC.

Moreover, his compensation as well as his tenure were within the control of the SEC. The SEC's willingness to reappoint him meant the difference between a salary which was over $14,000 a year by the time the present proceeding began and a retirement annuity of $4,700.

This provision of the APA is not a technical housekeeping rule of agency practice. It is a congressional declaration of the fundamental principle that an adjudicative officer should be given independence from outside pressures which might prevent him from holding the balance true between the parties who come before him for decision.

This is the same principle of independence guaranteed to Federal judges by the provision of Article III of the Constitution that they "shall hold their Offices during good Behavior, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office." Belief in the independence of adjudicative officers of course antedates the Constitution. One of the grievances asserted by the colonists against the King in the Declaration of Independence

was that he "had made Judges dependent on his Will alone for the tenure of their offices and the amount and payment of their salaries."

A robust understanding of human motivation underlies this principle. As Hamilton wrote in explanation of the Constitutional provision:

> "Next to permanency in office, nothing can contribute more to the independence of the judges than a fixed provision for their support . . . . *In the general course of human nature, a power over a man's subsistence amounts to a power over his will.*" The Federalist Papers, No. 78. (Emphasis supplied).

This Court has repeatedly recognized that even men of the highest motivation and the best intentions may be unfairly influenced by the possibility of a financial stake in how they decide cases. In *Tumey* v. *Ohio,* 273 U.S. 510 (1927), in which this Court unanimously invalidated on due process grounds a procedure whereby the officer trying a case could receive court costs in the event of conviction, Chief Justice Taft stated:

> "There are doubtless mayors who would not allow such a consideration as $12 costs in each case to affect their judgment in it, but the requirement of due process of law in judicial procedure is not satisfied by the argument that men of the highest honor and the greatest self-sacrifice could carry it on without danger of injustice. Every procedure which would offer a possible temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which might lead him not to hold the balance nice, clear and true between the state and the accused denies the latter due process of law." 273 U.S. at 532.

It is unfair to a Hearing Examiner to require that he function with the dispassionateness of a judge and at the same time deny him the independence of tenure and compensation guaranteed to judges by the Constitution and to Hearing Examiners by Section 11 of the APA. It is unfair to parties to subject them to a quasi-judicial administrative proceeding in which the Hearing Examiner is not insulated from the subtle pressures of dependency for continued tenure and compensation on the agency which appointed him.

Petitioner R. A. Holman & Co. was clearly prejudiced by being subjected to a proceeding before a disqualified Hearing Examiner. By decision of this Court, an agency is required to give weight to the decision of an "impartial, experienced examiner who has observed the witnesses and lived with the case." *Universal Camera Corp.* v. *National Labor Relations Board*, 340 U.S. 474 (1951). Indeed, it is precisely because of the probative force which must be given to the decision of the Hearing Examiner that "section 11 of the Administrative Procedure Act contains detailed provisions designed to maintain high standards of independence and competence in examiners." *Id.* at 495.

In evident recognition that it would be defending the indefensible to try to justify Hearing Examiner Swift's participation, the Court below declined to reach the merits of this contention. Instead it rested its decision solely on an alleged failure by R. A. Holman & Co. to make a "timely" challenge to the Hearing Examiner's qualifications.[8]

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[8] Section 7(a) of the APA provides that "upon the filing in good faith of a timely and sufficient affidavit of personal bias or disqualification of any such officer, the agency shall determine the matter as a part of the record and decision in the case." 5 U.S.C. § 1006(a).

In ruling thus, the Court below departed from the decisions of this Court as to what constitutes a timely challenge to the qualifications of an administrative hearing officer.

It is clear that the requirement of timely filing is intended to assure that the claim of disqualification can be passed on in the first instance by the agency before the administrative process is completed. Thus, in *Riss & Co.* v. *United States,* 341 U.S. 907 (1951), this Court held that a challenge made to the qualifications of a hearing officer on the last day of the hearings was timely.

In the present proceeding, objection to Swift's qualifications was made and decided by the SEC twenty months before the end of the hearings; twenty-nine months before Swift's recommended decision; and forty-two months before the final SEC decision.

Contrary to the opinion of the Court below, the decision in *Riss* was in no way qualified by this Court's subsequent decision in *United States* v. *L. A. Tucker Truck Lines,* 344 U.S. 33 (1952). *Tucker* merely held that objections to a Hearing Examiner not presented to the agency in the first instance are untimely. This Court stated that:

> "A litigant in such a case as this who does make such demand at the time of hearing is entitled to an examiner chosen as the Act prescribes." 344 U.S. at 36.

If *Tucker* in any way departs from *Riss,* or if this Court no longer adheres to this principle, it is for this Court to say so now.

Moreover, the Court below not only departed from established legal principles in its effort to avoid meet-

ing the contention on the merits, it also made an extraordinary finding of fact. Without ever seeing Swift and in the face of the undisputed sworn statements of R. A. Holman & Co.'s counsel that he did not know of Swift's age and status until April, 1962, the Court below concluded that counsel must have known Swift's age at the outset of the administrative proceeding.[9]

It also totally disregarded the undenied allegations in the complaint in the injunction action in the District Court for the District of Columbia, in which plaintiff stated:

> "The information as to Mr. Swift's birthday came to plaintiff's and its counsel's attention for the first time on April 25, 1962."
>
> * * *
>
> "Prior to April 25, 1962, plaintiff had no knowledge of the facts that disqualified Mr. Swift as Hearing Examiner."

The SEC admitted these allegations by failing to deny them in its answer in the injunction action, since under Rule 8(d) of the Federal Rules of Civil Procedure:

> "Averments in a pleading to which a responsive pleading is required, other than those as to the amount of damage, are admitted when not denied in the responsive pleading."

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[9] Counsel were not given access to the SEC files showing the basis on which Swift was given his temporary reappointments until May, 1962, after they had filed the motion to disqualify him.

Even if his age had been known at the outset of the proceedings, this would not have constituted disclosure that he was serving at the will of the SEC.

See *Reed* v. *Hickey,* 2 F.R.D. 92 (E.D. Penn. 1941); *Mahano* v. *United States,* 192 F.2d 873, 876 (1st Cir. 1951).

The conclusion of untimeliness is therefore untenable. Indeed, it is simply an additional reason for this Court to grant review in order to correct an obvious error in the interpretation of what is a timely disqualification motion under Section 7 of the APA.

**II. The Administrative Proceeding Is Invalidated by the Participation of Commissioner Woodside.**

Section 5(c) of the APA provides in unqualified terms that:

> "No officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency in any case shall, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review pursuant to section 1007 of this title except as witness or counsel in public proceedings." 5 U.S.C. 1004(c).

In this case it is undisputed that Commissioner Woodside was head of the Division of Corporate Finance of the SEC for a period of three and a half months during which time the Pearson registration statement was being processed there. It is conceded that he had responsibility to the SEC for the work of this division. It is undisputed that this registration statement led to the SEC investigation which in turn culminated in the suspension of the exemption for the Pearson offering and in the administrative proceeding against R. A. Holman & Co. It is also undisputed that Woodside participated throughout the administrative proceeding—joining in an undetermined number of

rulings by the SEC, including rulings relating to the question of his own disqualification—and finally withdrew, still asserting he was not disqualified, only on the eve of final argument before the SEC, over four years after the proceeding was commenced.

Such participation by Woodside is in conflict with the mandate of Section 5(c) of the APA and with the doctrine laid down by the Court of Appeals for the District of Columbia Circuit in *Amos Treat & Co.* v. *SEC, supra,* in which the Court said:

> "We are unable to accept the view that a member of an investigation or prosecuting staff may initiate an investigation, weigh its results, perhaps then recommend the filing of charges, and thereafter become a member of that commission or agency, participate in adjudicatory proceedings, join in commission or agency rulings and ultimately pass upon the possible amenability of the respondents to the administrative orders of the commission or agency. So to hold, in our view, would be tantamount to that denial of administrative due process against which both the Congress and the courts have inveighed.
>
> "Enough has been said to demonstrate the basis for our conclusion that an administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the very appearance of complete fairness. Only thus can the tribunal conducting a quasi-adjudicatory proceeding meet the basic requirement of due process." 306 F.2d at 226-67.

The Court below distinguished the *Treat* doctrine on a transparently insubstantial ground—that in *Treat* the challenged Commissioner himself disclosed his

participation in the investigation which led to the administrative proceedings, whereas here Woodside stood mute while others on the staff (some patently without knowledge) denied that Woodside had actively participated or had acquired "substantial knowledge" of the case. (It should be noted that in *Treat* the Commissioner there involved denied active participation but he made the apparently fatal mistake of being frank with the Court, and stating what part he had actually played, a role which the Court interpreted as more than sufficient to constitute active participation.) This distinction turns nondisclosure by a challenged Commissioner into a tactical advantage for him, a means of blocking the inquiry into his disqualification, and would go far toward nullifying the *Treat* doctrine.

### III. The SEC Denied Due Process in Curtailing Inquiry Into the Disqualification of Commissioner Woodside.

The SEC's restriction of inquiry into the facts relevant to the disqualification of Commissioner Woodside was itself a denial of due process to R. A. Holman & Co. in the administrative proceeding. If the record here does not show sufficient participation by Woodside in the investigation to disqualify him to sit in judgment on R. A. Holman & Co., it is precisely because the SEC—Woodside again participating—denied R. A. Holman & Co. the right and opportunity to make its record.

The District of Columbia Circuit, in holding that R. A. Holman & Co.'s interlocutory effort to enjoin the administrative proceeding was premature, specified that the company was entitled to a plenary administra-

tive hearing to inquire into the claim of disqualification. 323 F.2d at 287.

Instead R. A. Holman & Co. was allowed no further inquiry at all, much less a plenary one. The SEC denied it the right to subpoena staff members having knowledge of Woodside's role. Moreover, the SEC denied it the right to subpoena the man who had unique knowledge of Woodside's relation to the investigation before he became a Commissioner: Woodside himself. And Woodside participated in the SEC decision not to allow a subpoena for himself!

R. A. Holman & Co. was thus denied information it needed to carry the burden which was placed on it to prove Commissioner Woodside's disqualification. Yet the Court below, in upholding the denial of the administrative subpoenas, stated that R. A. Holman & Co. should have come forward with the very evidence of disqualification which it was attempting to utilize the subpoena process to obtain. The integrity of the administrative process is compromised by such an extraordinary concept of proper administrative procedure, which this Court would surely find intolerable in a judicial proceeding: "the ordinary rule, based on considerations of fairness, does not place the burden upon a litigant of establishing facts peculiarly within the knowledge of his adversary." *Campbell* v. *United States,* 365 U.S. 85, 96 (1961).

At the very minimum, due process of law (and the decision of the Court of Appeals for the District of Columbia Circuit in the earlier stage of this same proceeding) required disclosure of the facts relevant to this issue by the persons having knowledge, including the Commissioner involved. It is not due process,

when an issue of disqualification is clearly raised by strong *prima facie* evidence, for the only persons having full personal knowledge to refuse to state facts peculiarly and exclusively within his knowledge and necessary to permit the courts to resolve the issue.

This Court should grant review to assure that administrative agencies adhere to the fundamental principle sought to be implemented in Section 5(c) of the APA, that:

> "A fair trial in a fair tribunal is a basic requirement of due process. Fairness of court requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness . . . . [T]o perform its high function in the best way 'justice must satisfy the appearance of justice.'" *Re Murchison,* 349 U.S. 133, 136 (1955).

In the words of Chief Justice Hughes:

> "The maintenance of proper standards on the part of administrative agencies in the performance of their quasi-judicial functions is of the highest importance and in no way cripples or embarrasses the exercise of their appropriate authority. On the contrary, it is in their manifest interest. For, as we said at the outset, if these multiplying agencies deemed to be necessary in our complex society are to serve the purposes for which they are created and endowed with vast powers, they must accredit themselves by acting in accordance with the cherished judicial tradition embodying the basic concepts of fair play." *Morgan* v. *United States,* 304 U.S. 1, 22 (1938).

**IV. The Court Below Misapplied the Securities Act by Holding Stock Price Predictions Violative of Law in the Absence of Any Facts or Circumstances Showing That There Was No Reasonable Basis in Fact for the Predictions.**

The Court below held that the stock price predictions at issue in the District Court proceeding "were themselves violative of the antifraud provisions of the federal securities laws, since no adequate basis existed for representations so optimistic," relying on an earlier Second Circuit decision, *Berko* v. *SEC,* 316 F.2d 137, 143 (2d Cir. 1963). P. 22a, *infra.,* 366 F.2d at 458.

We submit that the Court below thereby misinterpreted the antifraud provisions of the securities laws and misapplied the *Berko* doctrine, totally overlooking the earlier opinion in the same case by Judge Marshall, *Berko* v. *SEC,* 297 F.2d 116 (1961).

*Berko I* held that in order for the SEC in an administrative proceeding to find statutory violations based on predictions of future stock prices, the SEC must clearly set forth in its decision the circumstances which made the stock price predictions without reasonable basis in fact at the time made. It must analyze the financial condition of the company involved and the information relied on by the salesman, and demonstrate the lack of basis for the predictions. In other words, there is no *per se* rule of violation based on stock price predictions.

*Berko I* was an administrative proceeding under the same statute as in the present case, involving prediction by a salesman that a stock would rise from $7 to $15 a share. The Court remanded the case to the SEC because of the Commission's failure to support, by analysis of the record, its findings and conclusion

that there was no reasonable basis in fact for the salesman's prediction. Judge Marshall wrote:

> "Although the SEC is far better equipped for such analysis than this Court, it failed to make any findings along these lines . . . . [T]he Commission eschewed any investigation or discussion of the information which Berko had and which he relied on." 297 F.2d at 118.

Judge Marshall made it explicit that this requirement derives from the statute itself:[10]

> "[T]he statute specifies the misleading nature of any statement is to be determined in the light of all the circumstances. But the Commission has not stated what surrounding circumstances persuaded it to rule this way. We should not and cannot resolve these questions without more complete findings and a clearer indication of the precise basis for its decision." *Ibid.*

As Judge Marshall stated in the companion case to *Berko I, Kahn v. SEC,* 297 F.2d 112, 114 (1961), which was remanded for the same purpose:

> "[A] straightforward affirmance on these grounds [that the salesman made optimistic stock price predictions] would establish an extraordinarily broad *per se* rule. *Upon remand, the Commission, in accordance with the statute, should state which, if any, of the surrounding circumstances made this statement 'misleading.'*" (Emphasis supplied).

It was only after *Berko I* was returned to the SEC for this purpose that the Commission decision was af-

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[10] The relevant statutory provision prohibits sales by means of "any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 15 U.S.C. § 77(a).

firmed in *Berko II,* the sole authority relied upon by the Court below for its holding that the price predictions in the present case violated the law.

In the present case this Court can search the findings and conclusions of the District Court and the opinion of the Court of Appeals in vain for any statement of the circumstances which made the price predictions without adequate basis in fact at the time they were made. There is not a line of analysis of the financial condition of Pearson at the time, or of the information on which the salesman relied. The courts below also totally ignored the Petitioners' evidence showing that there was a reasonable basis for the predictions.

Thus, the decision below imposes the very *per se* rule, with respect to stock price predictions, which *Berko I* held would violate the statutory mandate.

There is no justification for the staff of the SEC to ask the District Court to apply such a *per se* rule when, under *Berko I,* the SEC cannot do so in an administrative proceeding. The statutory requirements as to what constitutes a violation govern the courts and the SEC equally. The SEC should not be able to circumvent the duty imposed on it in an administrative proceeding to analyze the record simply by asking a District Court to adopt its proposed findings and conclusions wholesale and verbatim without any such analysis.

The process of decision which this case exhibits leaves the securities industry in a state of uncertainty inimical to the performance of its marketing func-

tions.[11] Do stock price predictions constitute a *per se* violation of the law? If not, under what circumstances will they? And do the answers depend on the forum in which the SEC elects to bring its charges?

The SEC has been criticized for its failure to exercise its rule-making powers to give notice and certainty in advance, instead of resorting to the unpredictable process of litigation to formulate policy.[12] Petitioners are unfortunate victims of that failure of the SEC.

Only review by this Court can dispel the uncertainties in the interpretation of the securities laws created by the decision below.

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[11] "Although the courts have exhibited a tendency to give the Commission substantial latitude in its efforts to suppress boiler shops . . . they have also expressed a deep aversion for the use of *per se* doctrines to prohibit expressions of values in the sale of securities . . . . It is obvious to me that these doctrines make it infinitely more difficult to sell the securities of a new company than those of an established company." Heller, *The Boiler-Shop Cases and The Reasonable Basis Rule*, Duke University School of Law, Conference on Securities Regulation, p. 81 (1964).

[12] Judge Friendly has said:

"I have sometimes felt that the Commission was slower to make particularized rules, especially under the 1934 Act and the Investment Advisors Act, than it needed to be. A rather high degree of precision seems especially desirable when an infraction of the rules can be made the basis for disciplinary proceedings." Proceedings, Conference on Codification of the Federal Securities Laws, 22 Business Lawyer 793, 901 (1967).

## CONCLUSION

For the foregoing reasons, it is respectfully submitted that the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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